



## STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

DRAFT

Date Introduced:	<b>02/21/07, as proposed to be amended</b>	Bill No:	<b>AB 538</b>
Tax:	<b>Sales and Use</b>	Author:	<b>Emmerson</b>
Related Bills:			

### BILL SUMMARY

This bill would, as proposed to be amended, provide a sales and use tax exemption to sales and purchases of new children's clothing sold to a nonprofit organization qualifying for exempt status under Section 501(c)(4) of the Internal Revenue Code for its distribution without charge to any children.

### ANALYSIS

#### CURRENT LAW

Under existing law, the sales tax applies to the sale of tangible personal property in this state, unless specifically exempted. The Sales and Use Tax Law provides no general statutory exemption from the sales or use tax merely because the seller or the purchaser is engaged in charitable activities, is a nonprofit organization, or enjoys certain privileges under property tax statutes or income tax statutes. However, current law is sprinkled with several separate provisions designed to assist various kinds of nonprofit groups engaged in charitable activities. For example, currently under Section 6375.5 of the Revenue and Taxation Code, a sales and use tax exemption applies to sales and purchases of new children's clothing that are sold to a nonprofit organization that has exempt status under Section 23701d of the Revenue and Taxation Code for its distribution without charge to *elementary* school children.

Current law also provides an exemption for sales by charitable organizations qualifying for the "welfare exemption" under Section 214 of the Revenue and Taxation Code, provided the organization is engaged in the relief of poverty and distress, and the sales are made principally as a matter of assistance to purchasers in distressed financial condition. Also, the property sold must have been made, prepared, and assembled or manufactured by the organization.

Another exemption from use tax exists when any seller (whether a retailer or a wholesaler) donates property to any organization in this state described in Section 170(b)(1)(A) of the Internal Revenue Code (those entities for which a deduction is allowed for contributions to charitable organizations).

#### PROPOSED LAW

This bill would amend Section 6375.5 of the Sales and Use Tax Law to expand the current sales and use tax exemption applicable to sales and purchases of new children's clothing, to do the following:

- Apply to the distribution to all children, rather than just elementary school children,

- Include nonprofit organizations that have exempt status under Section 501(c)(4) of the Internal Revenue Code, rather than just those qualifying for exempt status under 23701d of the Revenue and Taxation Code, and
- Eliminate the requirement that the nonprofit organization be engaged in the relief of poverty and distress.

As a tax levy, the bill would become effective upon enactment.

### BACKGROUND

Section 6375.5 was added to the Sales and Use Tax Law in 1982 by AB 2619 (Ch. 708, Stats. 1982). At that time, the bill was sponsored by a volunteer association that operated a “Clothes Corner,” the purpose of which was to distribute a minimum wardrobe to elementary school children who otherwise would be unable to attend school. The legislation sought to exempt purchases of children’s clothing by organizations of this type, to enable them to purchase more clothing with a given level of funds. This statute has not been amended since it was added into law.

### COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author to extend the current exemption for sales of new children’s clothing to other nonprofit organizations that provide similar services, but that qualify for exempt status under Section 501(c)(4) of the Internal Revenue Code, rather than Section 23701d of the Revenue and Taxation Code as the current statute requires.
2. **A specific situation is being addressed.** According to the author’s office, the bill is intended to apply to “ChildSpree” events held by Mervyn’s Department Stores, and similarly constructed events. The Mervyn’s events provide private \$100 shopping sprees to local children in need. Selected by a nonprofit organization or school partner, and accompanied by a volunteer chaperone, participating children are able to shop for new clothes and shoes. The children also receive a discount on all purchases made during the event. According to Mervyn’s website, since its 1992 inception, \$18.6 million has been donated to Mervyn’s ChildSpree and over 186,000 children have benefited from the program nationwide. The nonprofit organizations and schools in local communities coordinate the event and select the children. The organizations raise the money for each child, and Mervyn’s matches a portion of the raised funds. Two gift cards are generated: one for the funds raised by the nonprofit organization, and one containing the funds that Mervyn’s donates. The volunteer from the organization chaperones the child, and the gift cards are used to make the purchases of the items the child selects.

Some of the organizations that have participated in these events include the Salvation Army, United Way, the Jaycees, Kiwanis Club, local rotary clubs, Active 20/30 Club, Operation School Bell, various other charitable organizations, and local government social services agencies. Current law would allow the exemption for some of these organizations participating in these events, since they are 23701d organizations, but others, such as the Jaycees and Kiwanis Club, would not, since they are 501(c)(4) organizations.

**3. What are 23701d, 501(c)(3), and 501(c)(4)**

**organizations?** Section 23701d is one of California's state income tax provisions in the Revenue and Taxation Code granting an exemption from the state income tax to certain nonprofit organizations. Section 501 (c)(3) is a statute in the Internal Revenue Code that provides an exemption from federal income tax for similarly described nonprofit organizations. The organizations described in these statutes are generally organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals. There are about 115,000 such organizations in California.

Section 501(c)(4) organizations are also nonprofit, and include civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes. These organizations differ from 501(c)(3) organizations in that they are permitted to lobby for legislation and endorse political parties and candidates. There are over 9,000 such organizations in California. Prominent 501(c)(4) organizations include AARP, Kiwanis, the Jaycees and National Rifle Association.

**4. Enactment of this bill would not materially affect the Board's administration of this exemption.** In addition, retailers making sales to qualifying organizations on an ongoing basis would no longer be required to make a distinction between a qualifying 501(c)(3) organization and a non-qualifying 501(c)(4) organization.

**COST ESTIMATE**

The Board would incur minor costs to administer this measure. These costs would be attributable to, among other things, notifying retailers and auditing claimed amounts. An estimate of these costs is pending.

**REVENUE ESTIMATE**

This bill would to a small degree broaden the current exemption by 1) including all children, rather than just elementary school children, 2) including 501(c)(4) organizations as qualifying entities, and 3) eliminating the requirement that the nonprofit organization be engaged in the relief of poverty and distress. We do not anticipate the associated revenue losses to be significant – less than \$10,000 annually.

Analysis prepared by: Sheila T. Waters 916-445-6579 03/20/07

Contact: Margaret S. Shedd 916-322-2376

ls

0538-1sw.doc

*This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.*